

Council on Postsecondary Education
November 7, 2005

Comprehensive Funding Model Review

The Council has been involved in a comprehensive funding model review for almost two years. Recommendations resulting from the review have been developed consistently and in tandem with revisions to the public agenda. Attachment G-1 details a summary of all major revisions resulting from the review.

BENCHMARK FUNDING MODEL

A 1997 task force report on higher education reform which led to House Bill 1 recommended that the Council change its then funding approach for the following reasons:

- The existing funding formula was ignored.
- There was no linkage to a statewide strategic mission.
- Institutions were seeking “add-ons” to the formula.
- The existing enrollment-driven formula, in periods of changing demographics, rewarded wrong types of behavior, including incentives for increasing remedial education.
- The formula offered no direct incentives for collaboration and coordination.
- The formula had lost credibility.
- The formula did not provide sufficient incentives for enhancing the national competitiveness of Kentucky’s institutions.

House Bill 1 required a different funding approach as well - a new approach providing comparisons to national peers and linkages to the public agenda and House Bill 1.

- The six goals of House Bill 1 and their emphasis on achieving a standard of living in excess of the national average result in a funding approach which must look outward and compare funding levels to similar national peers, rather than competition among Kentucky institutions.
- House Bill 1 refers to “benchmarks” as a means of judging the progress toward its goals.
- The goals of House Bill 1 promote comparisons to national benchmarks as identified in the following excerpts:
 - Seamless, integrated system of postsecondary education strategically planned and **adequately funded** to enhance economic development and quality of life.
 - Major comprehensive research institution **ranked nationally** in the top 20 (UK).

- Premier, nationally recognized metropolitan research university (UofL).
- Regional universities, at least one....nationally recognized program of distinction...statewide access to baccalaureate and master's degrees of a quality at or above the national average.
- Efficient, responsive, and coordinated system of autonomous institutions that delivers educational services to citizens in quantities and of a quality that is comparable to the national average.

Benchmark Model - 2006-08

Background

Benchmark funding was developed and implemented for the 2000-02 biennium in response to the six goals established in the 1997 reform. The approach compares funding for Kentucky's postsecondary education institutions to national benchmark institutions to assist in determining the financial resources needed to achieve HB 1 goals.

The funding model used prior to the benchmark model compared Kentucky institutions with each other on the basis of credit hours by discipline. By contrast, the benchmark model looks outward comparing Kentucky institutions to national benchmarks for the purpose of meeting the legislative mandate that Kentucky's system deliver educational services in quantities and of a quality that is comparable to the national average.

The revised benchmark selection model used for 2006-08 differs from that used for 2004-06 as follows: (1) tighter criteria and process for benchmark selection; (2) differentiated more specifically based on mission and objectives in House Bill 1; and (3) measures included to ensure that performance comparisons relative to benchmark institutions are fair and meaningful.

Summary of revisions approved by the Council:

- Benchmark selection model revision (approved January 2005)
- Selection of all benchmarks (approved May 2005, July 2005-UK & UofL)
- Mandated program policies remained unchanged (approved April 2005)
- Funding Distribution Methodology (FDM) revised (approved January 2005)
- Institution match to access capital renewal and maintenance pool funds (confirmed existing policy January 2005)
- Review research space guidelines: no change from 2001 update (confirmed existing policy January 2005)
- Revisions to utilization and space needs model - teaching labs (updated policy January 2005)
- Exclude unrelated space from space needs model (confirmed existing policy January 2005)
- Condition and fit-for-use of space: conduct statewide analysis (approved January 2005)
- Institutional flexibility to issue agency bonds (supported policy change April 2005)

Additional changes included in 2006-08 Budget Recommendations:

1. Tuition Deduction
2. Standard Funding Level
3. Small Institution Adjustment (KSU)
4. Performance Funding Component

(1) Tuition Deduction

In previous versions of the benchmark model, a standard tuition deduction was used to make a policy statement about the appropriate share of the cost of educating a resident student between the student and the state. The previous standard can no longer be used to reflect the need for General Funds due to tuition increases. It is recommended that this calculation be modified to more accurately reflect funding need.

- **Deduction Calculation:** The tuition deduction is recommended to be the simple mean of tuition and fee revenue as a percent of total public funds of the benchmark institutions.

Rationale for Change:

- Accuracy - Since the model uses total public funds as the funding target, deducting the average of the benchmarks' tuition and fee revenue percentage is an actual estimate of the tuition dollars inherent in the total funding target. This deduction is simply the reciprocal tuition portion of the General Funds portion included in the target total public funds objective.
- Tuition and financial aid policy will be used to manage affordability concerns, so the funding model calculation will be used to determine adequate funding recommendations relative to the benchmark target. The Council's separate tuition policy for the complex issues related to affordability and share of responsibility will provide consistency between the funding model and tuition policy.

(2) Standard Funding Level

In the previous biennium the target funding level was referred to as the "measure of central tendency" and the 50th, 55th, and 60th percentiles were used to set the funding objective. The middle three institutions in most cases were used to determine the measure of central tendency.

This has been revised to a simple average of all of the benchmarks on each list plus 5 percent. Therefore, at full funding levels, the Kentucky institutions would be funded 5 percent above the average of their respective benchmarks.

(3) Small Institution Adjustment (KSU)

- Based on recommendations from the Baker-Hostetler report, the comprehensive funding model review evaluated the ability of the benchmark funding model to accurately reflect the needs of KSU given its small size and unique mission. It was determined that at such small levels of enrollment, the benchmark model does not adequately reflect funding needs at KSU. Since the main reason for this problem related to the small size of KSU and diseconomies of scale related to size, a small institution adjustment is recommended as the appropriate correction.
- The Funding Distribution Methodology will assume half of the adjustment will be considered a first priority base adjustment in the first year with the remainder in the equity distribution in the Funding Distribution Methodology. If the first year's adjustment is not fully funded, the remainder will be considered a first priority base adjustment in the second year. Unfunded portions of the adjustment will not carry forward to the next biennium.

(4) Performance Funding Component

Performance Component

The performance funding component is intended to provide incentives for institutions, through the base-funding model, to improve performance in the areas of critical importance to Kentucky's public agenda. The 2006-08 recommendations include a request for \$3,500,000 in performance funds to be distributed by the Council to the institutions in the second year of the biennium. If a smaller amount is appropriated, the greater of \$1 million or 5 percent of base funding for the institutional operating appropriation is recommended to be earmarked and appropriated to the Council for the distribution.

The Council will continue to work with the institutions to determine the performance indicators and distribution methodology for the performance component. It is anticipated that this will be presented for final approval January 2006.

Comprehensive Funding Review Comparison of Issues

2004-2005 Project

ATTACHMENT G-1

<i>Description of Change</i>	<i>Rationale for Change</i>	<i>Previous Model</i>	<i>Revised Model</i>
Benchmark Selection <u>CPE ACTION:</u> January - model March - refinement April - drafts May/July – benchmarks Nov – request	<ul style="list-style-type: none"> To link model to strategic planning process. To provide a more objective and equitable process. To incorporate performance component. To incorporate adequate differentiation among institutions. To enhance consistency between KCTCS and other institutions. To appropriately differentiate for UK and UofL House Bill 1 mandate. 	<ul style="list-style-type: none"> Cluster analysis based on 20 criteria. Not constrained by Carnegie Classification. Significant differences between benchmark lists and statistical model results (similarity measures not applied uniformly). Benchmark negotiations determined resulting benchmark lists. No performance component. 	<ul style="list-style-type: none"> Revised benchmark selection criteria. Constrained within two Carnegie Classifications. Strict and consistent adherence to statistical model results for selection of benchmarks. Weighting of criteria used to more effectively address differences in mission. Flexibility to select 19 out of the most similar 30 on statistical ranking lists for four-year institutions; 19 out of 23 state systems for KCTCS. Open process to discuss final selection parameters and proposed choices. Separate model for UK and UofL to address House Bill 1 mandate (based on specific measures and analyses).
Funding Distribution Methodology (FDM) <u>CPE ACTION:</u> Approved Jan 05	<ul style="list-style-type: none"> Current model makes M&O for new facilities and proportional increases too high a priority. Funding would have to reach too high a level before even one dollar is distributed to benchmark equity. Change in priorities allows past enrollment growth to be funded at a higher priority when funds are limited. Change in Equity Index to more appropriately address funding gaps and past enrollment growth. 	<ul style="list-style-type: none"> Priority 1 - Fully fund base adjustments including M&O on new facilities. Priority 2 - Proportional increase of 1% or 2% depending on funding levels and current services percentage. Priority 3 - Benchmark Equity. 	<ul style="list-style-type: none"> Priority 1 - Base adjustments (not M&O). Priority 2 - 50%/50% proportional/Benchmark Equity up to current services increase of net base funding level. Priority 3 - Fully fund M&O and if funds remain they revert back to priority 2. The current services rate specified in the FDM for capping purposes regarding proportional increases will be 2% for 2006-08 biennium
Performance Incentive <u>CPE ACTION:</u> Nov 05-earmark Jan 06-indicators/ methodology	<ul style="list-style-type: none"> To reward performance. To link funding model to the public agenda and campus action plans. 	<ul style="list-style-type: none"> No performance component in base model. 	<ul style="list-style-type: none"> Request 5% of 2008 recommendation for performance component distribution by the Council. Performance metrics and methodology will be developed and presented to the Council for approval in January 2006 Performance metrics will be consistent with public agenda, key indicators, and the campus action plans. If the Council's request is not fully funded, the Council will recommend that in the second year of the biennium no less than \$1 million or 5%, whichever is higher, of amount distributed to the institutions be earmarked in the Council's budget for performance.

Comprehensive Funding Review Comparison of Issues

2004-2005 Project

<i>Description of Change</i>	<i>Rationale for Change</i>	<i>Previous Model</i>	<i>Revised Model</i>
Tuition Deduction <u>CPE ACTION:</u> November 05	<ul style="list-style-type: none"> To equitably and accurately account for revenue available for student funding. Standard deductions no longer reflected reality of the share of tuition to total public funds and therefore more General Funds than needed to fully fund total public funds were requested under a standard deduction (over \$100 million (or one third) of 2004-06 funding gap was related to revenue above the standard deduction which was not counted). To ensure that the calculations of funding need in the benchmark model are accurately impacted by the Council's tuition policy currently under development (including tuition decisions regarding nonresident students). Tuition policy changes should be captured automatically in the benchmark calculations. 	<ul style="list-style-type: none"> Uses standard deduction, so tuition and fee revenue higher than standard percentage is not counted in the model thereby inflating General Fund recommendation. Standard deduction was 37% for all institutions except for KCTCS and KSU, which is 30%. Differentiation in price for nonresident student tuition was not fully captured by the benchmark calculation. Model allowed the recommendation, in some instances, to extend beyond the total need generated by the model. 	<ul style="list-style-type: none"> The benchmark model determines adequacy of funding based on the total public funds of the benchmark institutions. Since only general funds are requested, tuition amounts must be deducted to determine the general funds target. The new tuition deduction is the simple average of tuition percentages in each benchmark list. This is tuition and fee reciprocal to the General Fund need contained in the total public funds of the benchmark objective The funding gap calculation is capped at 105% of the total public funds objective identified by the model.
Measure of Central Tendency (Standard Funding Level) <u>CPE ACTION:</u> November 05	<ul style="list-style-type: none"> To make the measurement more statistically sound (too few benchmark institutions for percentile calculation). To use the data from more than a few of the benchmark institutions in the calculation of funding objective. 	<ul style="list-style-type: none"> Average of the 50th, 55th, and 60th percentile out of 19 benchmark institutions. 	<ul style="list-style-type: none"> Revised and labeled "standard funding level." The funding level will be based on funding levels of benchmark peer institutions and is recommended for Fiscal Year 2006-08 biennium to be at 5% above the average of the benchmarks

Comprehensive Funding Review Comparison of Issues

2004-2005 Project

<i>Description of Change</i>	<i>Rationale for Change</i>	<i>Previous Model</i>	<i>Revised Model</i>
Mandated Program Deduction <u>CPE ACTION:</u> May 05	<ul style="list-style-type: none"> Deduction for various mandated programs may be biased and collections are incomplete and difficult to verify. Except for land grant and agriculture, benchmark institutions have little incentive to report on legislatively mandated programs (they have no reason to separately track these programs). Since the model identifies similar institutions, it may be reasonable to assume that these institutions have similar mandated programs (however, Kentucky has fewer major research universities so Kentucky data may be higher than benchmark peers). To the extent that the data are biased, this component could inflate the funding objective; if data are not biased, better collection procedures could be implemented. 	<ul style="list-style-type: none"> Manual survey goes out to each benchmark institution requesting data on legislatively mandated programs. These data are subtracted from all institutions. Mandated programs must meet certain criteria to be included on the list. 	<ul style="list-style-type: none"> Maintain current practice, but implement more effective collection procedures to minimize potential data bias.
Small Institution Adjustment <u>CPE ACTION:</u> November 05	<ul style="list-style-type: none"> To address the issue of diseconomies of scale facing smaller institutions with headcount enrollments of less than 4,000. Based on Baker Hostetler report and Council analysis, the benchmark model underestimates the funding need for institutions as small as KSU and this new calculation should be substituted for the benchmark calculation. 	<ul style="list-style-type: none"> No fixed cost adjustment. Benchmark model showed a negative funding need and as a result only a 2% increase was recommended for KSU in previous biennia 	<ul style="list-style-type: none"> Using methodology developed from the Alabama funding model, a small institution adjustment is calculated based on cost factors. Half of the total calculation is requested as a first priority base adjustment and the remaining half distributed over the remainder of the four-year funding plan.

Comprehensive Funding Review Comparison of Issues

2004-2005 Project

CAPITAL

<i>Description of Change</i>	<i>Rationale for Change</i>	<i>Previous Model</i>	<i>Revised Model</i>
Institutional Match to Construct Research Space <u>CPE Action:</u> November 05	<ul style="list-style-type: none"> • Institutions have a revenue stream available to share debt service. • There are limited funds available from the state for capital construction and postsecondary education competes for limited debt capacity. • To recognize changing grant funds environment and ability of institutions to fund the match. • Many states fall into the 40% to 100% category of institutional support to construct research space; however, many states have significantly front-loaded 100% state paid research. 	<ul style="list-style-type: none"> • Institutions are asked to share the responsibility for construction of research space (40 cents on the dollar). • Recognition of available revenue stream that can be dedicated to the capitalized cost of providing research space. • Since 1997 research space has been requested by the Council and the Governor, and funded by the General Assembly as a shared responsibility. • In the 2004-06 budget process, the Council recommended 60/40. In January 2004, the Governor requested 50/50, but the General Assembly did not pass a budget that year. 	<ul style="list-style-type: none"> • Council will continue to analyze the need for a match in research space for future biennia in light of limited debt capacity for postsecondary projects and the ability of these projects to generate revenue. • For the 2006-08 biennium, only 50% of the scope of the research and economic development projects is recommended; therefore, if the Council determines a match is required, it can be implemented with the recommendation in the 2008-10 biennium when the remaining project scopes are likely to be funded.

Comprehensive Funding Review Comparison of Issues

2004-2005 Project

<i>Description of Change</i>	<i>Rationale for Change</i>	<i>Previous Model</i>	<i>Revised Model</i>
Institutional Match to Access State Funds in Capital Renewal and Maintenance Pools	<ul style="list-style-type: none"> Recognizes institutional performance in addressing ongoing major maintenance of E&G facilities. Recognizes the shared responsibility between the state and the institution for facilities maintenance. Recognizes and encourages institutions to budget for ongoing major maintenance of E&G facilities. 	<ul style="list-style-type: none"> Policy is that institutions should share the responsibility for deferred maintenance, capital renewal, and maintenance of facilities (match range is \$0.75 to \$1 per each \$1 of state funds). Does not recognize efforts by institutions to budget for the ongoing major maintenance of E&G facilities. 	<ul style="list-style-type: none"> Continue the current policy to require an institutional match to access state funds in capital renewal pool with match ranges between \$0.60 - \$1 per each \$1 of state funds. Strengthen the evaluation of institutional performance on postsecondary education maintenance standard.
Capital Projects Planning and recommendation priorities <u>CPE Action:</u> May 2005	<ul style="list-style-type: none"> Responds to a request by the Capital Planning Advisory Board and implements a policy adopted by the Council in July 2001. The planning priorities reported to the CPAB may change when a capital projects recommendation is made to the Governor. 	<ul style="list-style-type: none"> The Council typically provides capital priority categories to the Capital Planning Advisory Board. Projects recommended by the Council in the prior biennial recommendation not authorized by the General Assembly are typically identified as the priorities for the upcoming biennium. 	<ul style="list-style-type: none"> Statewide capital priorities are established by a model based on evaluative criteria consistent with the goals and objectives of the public agenda. This model was used to rank projects for the 2006-08 biennium. Research and economic development projects are categorized and evaluated separately from academic projects.